

**DEPARTMENT OF TAXATION  
2011 Fiscal Impact Statement**

1. **Patron** Jeffrey L. McWaters

2. **Bill Number** SB 1365

3. **Committee** Senate Finance

**House of Origin:**

  X   **Introduced**

       **Substitute**

       **Engrossed**

4. **Title** State insurance license tax credit

**Second House:**

       **In Committee**

       **Substitute**

       **Enrolled**

**5. Summary/Purpose:**

This bill would provide a tax credit against the license tax to insurance companies that invest in Virginia small business investment companies, which would in turn be required to invest in "qualified businesses." The credit would be equal to 80 percent of the investment of capital. The insurance company would be allowed to claim one-sixth of the license tax credit in any taxable year beginning on or after January 1, 2013, provided it does not exceed the state license tax liability for the taxable year. Any unused credit against state license tax liability could be carried forward indefinitely until the license tax credits are used.

The total amount of the license tax credits allowed would be capped at \$100 million for all years. If the total license tax credits claimed by all participating investors exceeded \$100 million, then the total amount of license tax credits would be allocated on a pro rata basis. The pro rata amount would be the product of (i) a fraction, the numerator of which is the amount of the license tax credit allocation claim filed on behalf of the participating investor and the denominator of which is the total amount of all license tax credit allocation claims filed on behalf of all participating investors; and (ii) the total amount of designated capital for which license tax credits would be allowed. The Department of Business Assistance ("DBA") would accept license tax credit allocation claims within 90 days of the effective date of this bill and would be required to notify each Virginia small business investment company within thirty days of accepting license tax credit allocation claims of the amount of tax credits allocated to each participating investor.

Under this bill, an insurance company, group of insurance companies, or other persons who may have state license tax liability or the affiliates of the insurance companies would not be allowed the credit if they manage or own a Virginia small business investment company, or control the direction of investments that a small business investment company makes.

**6. Budget amendment necessary:** No.

**7. Fiscal Impact Estimates are: Preliminary. (See Line 8.)**

**7b. Revenue Impact:**

<i>Fiscal Year</i>	<i>Dollars</i>	<i>Fund</i>
2010-11	\$0	GF
2011-12	\$0	GF
2012-13	\$11.1 Million	GF
	\$5.6 Million	TTF
2013-14	\$11.1 Million	GF
	\$5.6 Million	TTF
2014-15	\$11.1 Million	GF
	\$5.6 Million	TTF
2015-16	\$11.1 Million	GF
	\$5.6 Million	TTF
2016-17	\$11.1 Million	GF
	\$5.6 Million	TTF

**8. Fiscal implications:**

Administrative Costs

TAX and the SCC consider implementation of this bill as routine, and do not require additional funding.

The Department of Business Assistance (DBA) would require one additional FTE as a result of this bill.

Revenue Impact

This bill would reduce General Fund revenue by \$11.1 million and the Transportation Trust Fund by \$5.6 million, for a total of \$16.7 million, for Fiscal Years 2013 through 2018.

This revenue impact assumes that insurance companies will be able to claim up to the full one-sixth of total credits in any given taxable year. Under current Virginia law, revenue from the insurance premiums tax is split between the General Fund and the Transportation Trust Fund, with two-thirds appropriated to the General Fund and one-third appropriated to the Transportation Trust Fund.

**9. Specific agency or political subdivisions affected:**

Department of Taxation  
Department of Business Assistance  
State Corporation Commission

**10. Technical amendment necessary: No.**

## 11. Other comments:

### Proposed Legislation

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### *Application Procedures*

This bill would require application procedures to be established for small business investment companies. These procedures would require an applicant to file an application and pay a nonrefundable application fee of \$7,500. The application would be required to include an audited balance sheet of the applicant, with an unqualified opinion from an independent certified public accountant, as of no more than 35 days before the date of the application.

In order to qualify as a Virginia small business investment company, an applicant must have:

- An equity capitalization of at least \$500,000 in the form of unencumbered cash or cash equivalents;
- At least two principals or persons employed to manage the funds of the applicant with at least five years of experience in the venture capital or private equity industry; and
- Satisfied any additional requirement.

The application, organizational documents, and business history of each applicant would be reviewed, and a determination would be issued no later than the thirtieth day after the date an application is filed. If an applicant satisfies all the requirements, it will be issued a certification; however, if it fails to satisfy the requirements, the small business investment company would not be issued the certification and the applicant would receive in detail the grounds for the refusal, including suggestions for the removal of those grounds.

Under this bill, an insurance company, group of insurance companies, or other persons who may have state license tax liability or the affiliates of the insurance companies would not be allowed the credit if they manage or own a Virginia small business investment company, or control the direction of investments that a small business investment company makes.

#### *Definition of a "Qualified Business"*

A "qualified business" would mean a business that, at the time of a Virginia small business investment company's first investment in the business:

- Is headquartered in the Commonwealth and intends to remain in the Commonwealth after receipt of the investment by the Virginia small business investment company;
- Has its principal business operations located in the Commonwealth and intends to maintain business operations in the Commonwealth after receipt of the investment by the Virginia small business investment company;
- Has agreed to use the qualified investment primarily to (i) support business operations in the Commonwealth, other than advertising, promotion, and sales operations that may be conducted outside of the Commonwealth; or (ii) in the case of a start-up company, establish and support business operations in the Commonwealth, other than advertising, promotion, and sales operations that may be conducted outside of the Commonwealth;
- Has not more than 100 employees and (i) employs at least 80 percent of its employees in the Commonwealth; or (ii) pays 80 percent of its payroll to employees in the Commonwealth;
- Is primarily engaged in (i) manufacturing, processing, or assembling products; (ii) conducting research and development; or (iii) providing services;
- Is not primarily engaged in (i) retail sales, other than direct sales of products manufactured by such business; (ii) real estate development; (iii) the business of insurance, banking, or lending; or (iv) the provision of professional services provided by accountants, attorneys, or physicians; and
- Is not a franchise of and has no financial relationship with a Virginia small business investment company or any affiliate of a Virginia small business investment company prior to a Virginia small business investment company's first qualified investment in the business.

A business classified as a qualified business at the time of the first qualified investment in the business would remain classified as a qualified business and could receive continuing qualified investments from any Virginia small business investment company. Continuing investments would constitute qualified investments even though the business may not meet the definition of a qualified business at the definition of a qualified business at the time of the continuing investments.

#### *Verifying Qualified Businesses*

This bill would allow a Virginia small business investment company, before making an investment, to request a written opinion whether a business in which it proposes to invest

is a qualified business. If the DBA does not respond by the fifteenth business day after the date of the receipt of the request, the business in which the company proposes to invest is considered to be a qualified business.

### *Reporting Requirements*

This bill would require each Virginia small business investment company to report the name of each participating investor from whom the designated capital was received, including the participating investor's insurance license tax identification number; the amount of each certified investor's investment of designated capital and license tax credits; and the date on which the designated capital was received.

A Virginia small business investment company would be required, no later than January 31 of each year, to report the following information:

- The amount of the company's designated capital at the end of the preceding year;
- Whether or not the company has invested more than 15 percent of its total designated capital in any one business without specific approval;
- Each qualified investment that the company made during the preceding year and, with respect to each qualified investment, the number of employees of the qualified business at the time the qualified investment was made; and
- Any other information required.

The small business investment company would be required to provide, no later than June 1 of each year, an annual audited financial statement that includes the opinion of an independent certified public accountant.

### *Renewal and Investment Amounts*

This bill would require that a Virginia small business investment company pay a nonrefundable renewal fee of \$5,000 no later than January 31 of each year in order to renew its certification. If a Virginia small business investment company fails to pay its renewal fee on or before that date, the company would be required to pay, in addition to the renewal fee, a late fee of \$5,000 to continue its certification.

In order for a Virginia small business investment company to continue to be certified, it would need to make qualified investments according to the following schedule:

- Before the second anniversary of an allocation date, a Virginia small business investment company must have made qualified investments in an amount cumulatively equal to at least 35 percent of the designated capital allocated, of which at least 15 percent must be in strategic investment areas; and
- Before the third anniversary of an allocation date, a Virginia small business investment company must have made qualified investments in an amount cumulatively equal to at least 50 percent of the designated capital allocated, of which at least 15 percent must be in strategic investment areas.

If, within five years after an allocation date, a Virginia small business investment company has not invested at least 80 percent of the designated capital allocated, of which at least 15 percent must be in strategic investment areas, the Virginia small business investment company would not be permitted to pay management fees. Likewise, a Virginia small business investment company would not be permitted to continue to pay management fees if, within seven years after an allocation date, a Virginia small business investment company has not invested at least 100 percent of the designated capital allocated.

#### *Relocation Provision*

Under this bill, if a business in which a qualified investment is made relocates its principal business operations to another state within 24 months of the date of a qualified investment in a qualified business, the cumulative amount of qualified investments made by the Virginia small business investment company would be reduced by the amount of the Virginia small business investment company's qualified investments in the business that has relocated.

#### *Recapture Provision*

This bill would provide that a Virginia small business investment company that fails to continuously satisfy the requirements of this article would be decertified. This would potentially lead to the recapture of license tax credits.

#### *Promulgation of Regulations and Other Guidance*

This bill would require that the DBA, in consultation with the SCC, publish guidelines regarding the administration of the tax credit no later than July 1, 2011. In addition, this bill would require that the DBA, in consultation with the SCC, adopt regulations to facilitate the transfer or assignment of license tax credits by participating investors. Under this bill, a participating investor would not be allowed to transfer or assign, agree to transfer, or agree to sell or assign license tax credits until 180 days from the date on which the participating investor invested designated capital.

#### *Definitions*

"Affiliate" of another person would mean:

- A person who directly or indirectly (i) beneficially owns 15 percent or more of the outstanding voting securities or other voting interests of the other person, whether through rights, options, convertible interests, or otherwise; or (ii) controls or holds power to vote 15 percent or more of the outstanding voting securities or other voting interests of the other person;
- A person of which 15 percent or more of the outstanding voting securities or other voting interests are directly or indirectly (i) beneficially owned by the other person, whether through rights, options, convertible interests, or otherwise; or (ii) controlled or held with power to vote by the other person;
- A partnership in which the other person is a general partner; or

- An officer, director, employee, or agent of the other person, or an immediate family member of the officer, director, employee, or agent.

"Allocation date" would mean the date on which the participating investors in a Virginia small business investment company were allocated designated capital.

"Designated capital" would mean an investment of cash by a participating investor in a Virginia small business investment company that fully funds the purchase price of an equity interest in the company or a qualified debt instrument issued by the Virginia small business investment company.

"Virginia small business investment company" would mean a partnership, corporation, trust, or limited liability company, whether organized on a profit or not-for-profit basis, that (i) has its principal office located or is headquartered in Virginia; and (ii) has as its primary business activity the investment of cash in qualified businesses and that is certified as meeting the criteria of this program.

"Participating investor" would mean an insurance company or other person that has state license tax liability, other than a title insurance company, that contributes designated capital pursuant to an allocation of license tax credits.

"License tax credit allocation claim" would mean a claim for allocation of license tax credits.

"Person" would mean an individual or entity, including a corporation, general or limited partnership, trust, or limited liability company.

"Qualified debt instrument" would mean a debt instrument issued by a Virginia small business investment company, at par value or a premium, that (i) has an original maturity date of at least four years after the date of issuance; (ii) has a repayment schedule that is not faster than a level principal amortization over four years; and (iii) has no interest or payment features that allow for the prepayment of interest or are tied to the profitability of the Virginia small business investment company or the success of its investments.

"Qualified distribution" would mean any distribution or payment by a Virginia small business investment company in connection with:

- The reasonable costs and expenses of forming, syndicating, managing, and operating the company, provided that the distribution or payment is not made directly or indirectly to a participating investor, including (i) reasonable and necessary fees paid for professional services, including legal and accounting services, related to the formation and operation of the company; and (ii) an annual management fee in an amount that does not exceed two percent of the designated capital of the company; and
- Any projected increase in federal or state taxes, including penalties and interest related to state and federal income taxes, or the equity owners of the company resulting from the earnings or other tax liability of the company to the extent that the increase is related to the ownership, management, or operation of the company.

"Qualified investment" would mean the investment of cash by a Virginia small business investment company in a qualified business for the purchase of any debt, debt participation, equity, or hybrid security of any nature or description, including a debt instrument or security that has the characteristics of debt but that provides for conversion into equity or equity participation instruments such as options or warrants.

"State license tax liability" means any liability incurred by any person under Article 1 (§ 58.1-2500 et seq.) of Chapter 25.

### Other States

This type of program is offered in several other states, including Wisconsin, Florida, Louisiana, Missouri, New York, and Tennessee. The program requirements vary by state. For example, Wisconsin provides tax incentives for what it considers investments by insurance companies in Certified Capital Companies (CAPCOs), which are organizations whose primary business activity is investing in "qualified businesses." Under Wisconsin law, the total amount of tax credits allowed is \$50 million, and an insurer may take credit for its investments in CAPCOs at the rate of 10 percent per year for 10 years. Any unused credits may be carried forward to future tax years.

Under Tennessee law, a total of \$120 million in investment tax credits is allowed to insurance companies that invest in entities certified by Tennessee as "TNInvestcos." Such credits are awarded in \$20 million allocations, with no more than two allocations being awarded to any single TNInvestco. TNInvestcos are required to invest the funds in qualifying Tennessee small and start-up businesses.

### Similar Bills

**House Bill 2283** would create a similar tax credit against the license tax for insurance companies that invest in Virginia small business investment companies.

**House Bill 2335** and **Senate Bill 1359** would enhance the retaliatory tax credit that certain insurance companies can claim against the insurance premiums license tax.

**Senate Bill 1124** would require TAX and the SCC to enter into a memorandum of understanding to facilitate the transfer of the insurance premiums tax from the SCC to TAX.

cc : Secretary of Finance

Date: 1/24/2011 KLC  
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